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Rates Spark: France still singled out

Revived diplomatic efforts around the Middle East lift market sentiment, but French spreads still widened beyond 150bp. Fiscal concerns and public unrest clearly weigh on French government bonds (OATs), but more is at play



Recent unrest is adding to concerns around President Macron and France's ability to consolidate its finances

France remains singled out, but it's not pure credit concerns

Risk sentiment was more upbeat after headlines suggesting a revival of diplomatic efforts to end the Middle East conflict. Energy prices retreated from their recent highs, stocks advanced, and yields edged lower. Still, markets have learnt to treat such headlines with a healthy dose of scepticism.

Within the European government bond space, a tentative stabilisation of spreads over Bunds mirrored the improved sentiment. However, France continues to be singled out, with the 10y spread pushing past 150bp. We had cautioned that the public unrest was adding to concerns around France's ability to consolidate its finances. The unrest also adds very direct costs in terms of lost GDP, as our economist warns.

Back during the days of the sovereign debt crisis, the French spread versus Germany peaked at just below 200bp. But bear in mind, this was when Italian spreads pushed past 500bp and markets were contemplating the tail risk of a collapsing monetary union, i.e., redenomination risk.

To add some perspective, a 10y spread of close to 200bp in late 2011 meant that French bonds yielded more than twice as much as German Bunds. The 10y Bund yield stood at around 1.9%. Nowadays, French 10y bonds, at just below 5%, yield less than 1.5 times as much as their German counterpart. And that 5% mark in outright yields appears to remain a hurdle for OATs for now.

This is not to say that spreads cannot push further, especially in the absence of any good news and with a long way to go until the presidential elections. But it is important to highlight that there are other factors pushing spreads wider that do not directly reflect pure credit concerns. Overall, rates volatility has increased and weighs on spreads more generally. Especially when market liquidity is subdued, this can exacerbate widening pressures across EGBs. The French CDS spread, for that matter, while wider, is still 160bp away from its 2011 peaks rather than a bit over 40bp when looking at the bond spread.

Wednesday's events and market view

Following the UK CPI release in the morning, it will be a quiet day in terms of data. The main focus will be the public appearances of BoE Governor Bailey and ECB President Lagarde.

In the primary government bond markets, the US will auction 20y bonds (US$13bn). The European primary is quiet. Italy's two retail BTP Valore bonds are still open for subscription through the week.

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